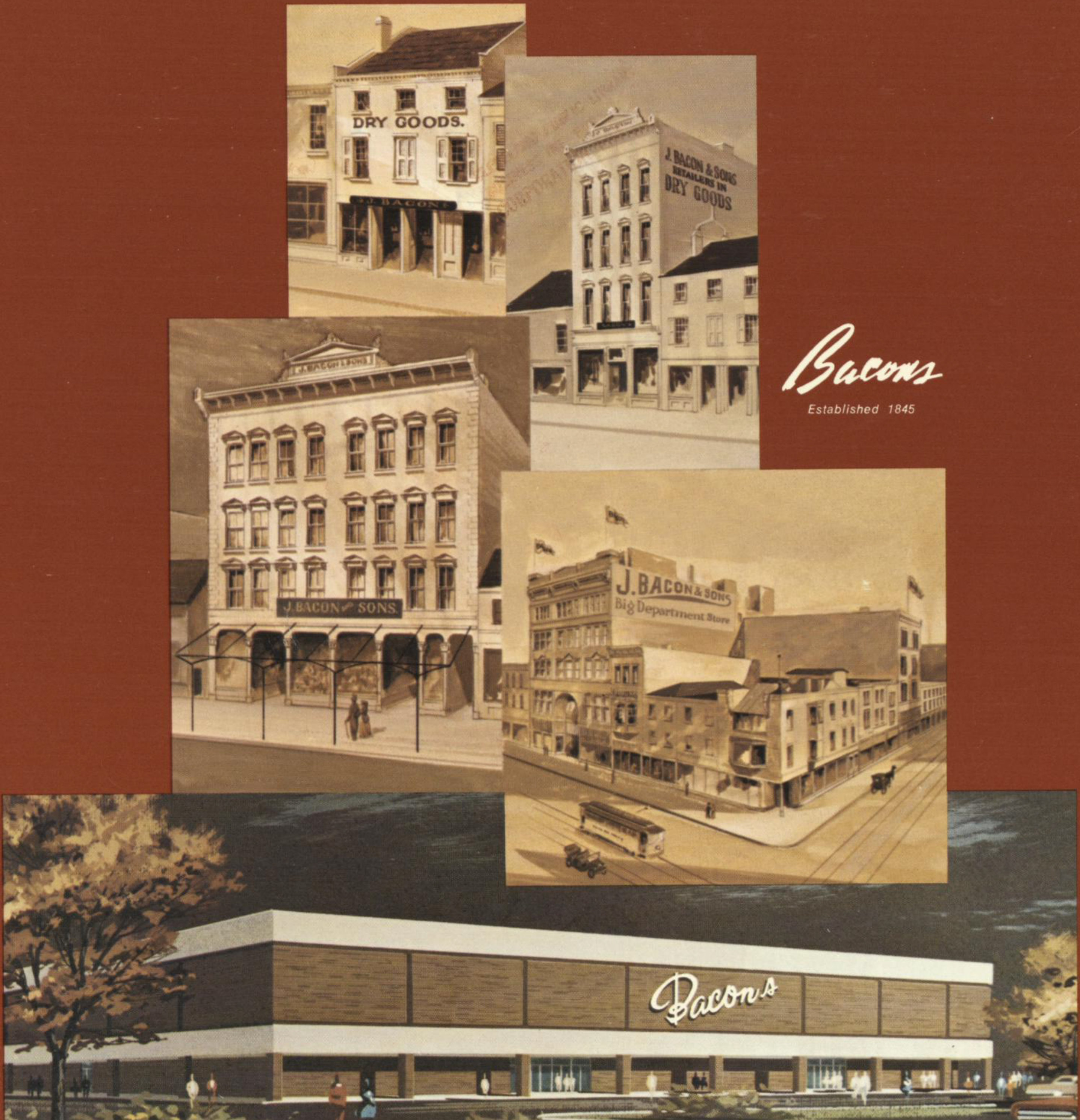
Mercantile Stores Company, Inc.

Annual Report 1974


DRY GOODS.
J. BACON
J. BACON & SONS
RETAILERS IN
DRY GOODS
J. BACON & SONS
J. BACON & SONS
J. BACON & SONS
Big Department Store
Bacon's

Bacons

Established 1845

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Annual Meeting

The Annual Meeting of Stockholders will be held at 11:00 a.m., on Wednesday, May 28, 1975 at 100 West 10th Street, Wilmington, Delaware. All stockholders are cordially invited to attend.

Form 10-K Annual Report

A copy of Mercantile's 1974 Form 10-K Annual Report as filed with the Securities and Exchange Commission is available upon request by writing:

Office of the Secretary
Mercantile Stores Company, Inc.
100 West 10th Street
Wilmington, Delaware 19899

Directors

† John E. Bierwirth
Chairman and a director of
National Distillers and Chemical Corporation.

Frederick W. Bleckwenn
Vice-President
Mercantile Stores Company, Inc.

† William W. Geddes
President and Chief Executive Officer and a
director of Wilmington Trust Company,
Wilmington, Delaware.

* Harold W. Jockers
Chairman of the Executive Committee
Mercantile Stores Company, Inc.

* F. G. Kingsley
Vice-President and a director of
Deering Milliken, Inc.

* James C. Lovell
President,
Mercantile Stores Company, Inc.

Gerrish H. Milliken
Vice-President and a director of
Deering Milliken, Inc.

* Minot K. Milliken
Vice-President, Treasurer and a
director of Deering Milliken, Inc.

*† Roger Milliken
President and a director of
Deering Milliken, Inc.

† George S. Moore
Director of White, Weld & Co. Incorporated
and a director of
Credit Suisse-White, Weld & Co. Limited.

Edward J. Sharkey
Vice-President
Mercantile Stores Company, Inc.

R. Nelson Shaw
Consultant
Mercantile Stores Company, Inc.

Charles E. Stallings
Vice-President
Mercantile Stores Company, Inc.

* Leon F. Winbigler
Chairman of the Board
Mercantile Stores Company, Inc.

* *Executive Committee*
† *Audit Committee*

Officers

Leon F. Winbigler
Chairman of the Board

James C. Lovell
President

Harold W. Jockers
Chairman of the Executive Committee

F. G. Kingsley
Chairman of the Finance Committee

Frederick W. Bleckwenn
Vice-President

William A. Heineman
Vice-President and Treasurer

Edward J. Sharkey
Vice-President

Charles E. Stallings
Vice-President

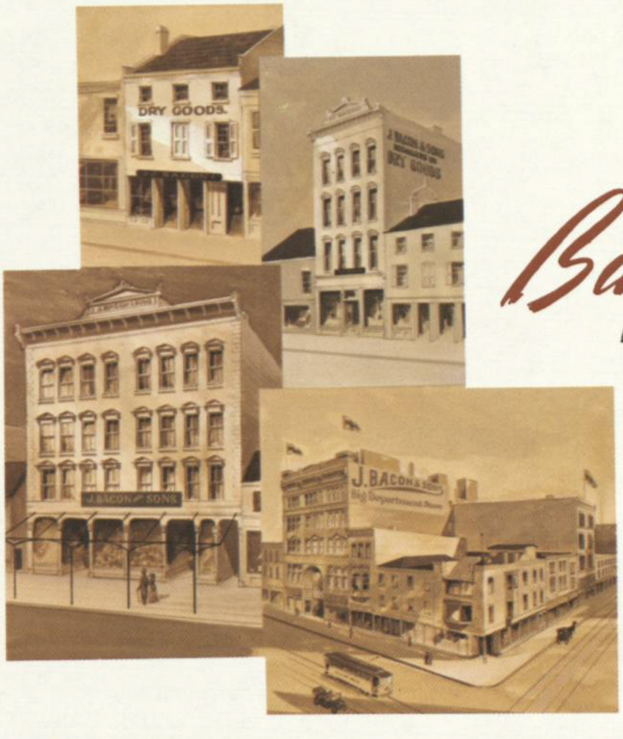
Walter H. Bosch
Controller

Dennis F. Murphy
Secretary

CLEVELAND PUBLIC LIBRARY
BUSINESS INF. BUR.
CORPORATION FILE

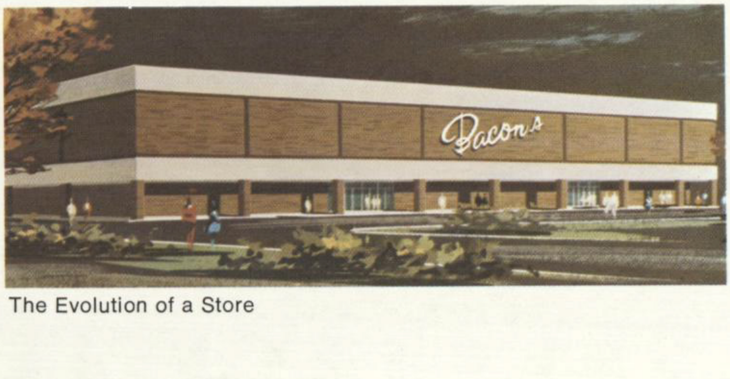
Mercantile Stores Company, Inc.

100 West 10th Street—Wilmington, Delaware



Bacons

Established 1845



The Evolution of a Store

Financial Highlights in Brief

	1974 (Year Ended Jan. 31, 1975)	1973 (Year Ended Jan. 31, 1974)
Operating Results:		
Net sales	$563,861,000	$518,106,000
Sales increase percentage	8.8%	13.0%
Income before Federal income taxes	40,229,000	40,695,000
Percent to sales	7.1%	7.9%
Net income *	21,034,000	21,625,000
Percent to sales	3.7%	4.2%
Per Common Share:		
Net income *	$3.57	$3.67
Dividends	.80	.77½
Financial Position:		
Working capital	$102,181,000	$ 95,248,000
Ratio of current assets to current liabilities	2.74	2.47
Receivables — net	14,646,000	13,960,000
Due from Mersco Finance Corporation	49,429,000	47,257,000
Inventories	82,803,000	87,139,000
Property and equipment — net	106,290,000	93,907,000
Total assets	273,873,000	260,529,000
Long-term debt	34,656,000	32,799,000
Stockholders' equity	173,021,000	156,703,000
Per common share	29.35	26.58
Ratio of net income to invested capital	12.8%	14.6%
Stores at end of year	71	72
Total square feet	7,538,000	7,372,000

* Net income for 1974 was reduced by $1,538,000, or 26 cents per share, as a result of the Company's adoption of the last-in, first-out method of inventory valuation for all domestic retail inventories.

To Our Stockholders

April 10, 1975

Sales

Sales for the year ended January 31, 1975 were $563,861,000, an increase of 8.8% over the $518,106,000 for the previous year, the 19th consecutive year in which annual sales reflected an increase over the preceding year.

The sales increase in this latest year was somewhat less than that experienced for the previous year when sales increased by 13% from $458,328,000 to the aforementioned $518,106,000. However, in the previous year ended January 31, 1974, we added two new stores, replaced two units with larger stores and expanded two units at various times which contributed to the sales increase. In this latest year, the pace of expansion was reduced, with only the opening of a small 25,000 square foot store and the doubling of space in two 80,000 square foot stores.

Sales were expanding at a satisfactory pace the first part of the year. A noticeable slowdown appeared in September and continued for the balance of the year with sales only up by 2.2% for the important fourth quarter and an actual decrease in the month of January, 1975.

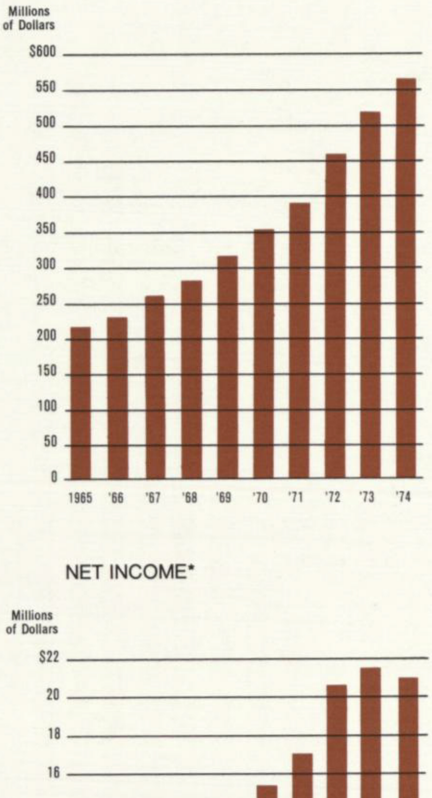
Net Sales (thousands)

Quarter	1974	1973	Quarter Percent Increase	Year-to-Date Percent Increase
1st	$116,171	$102,645	13.2	13.2
2nd	132,811	116,280	14.2	13.7
3rd	135,629	123,858	9.5	12.2
4th	179,250	175,323	2.2	8.8
	$563,861	$518,106		8.8

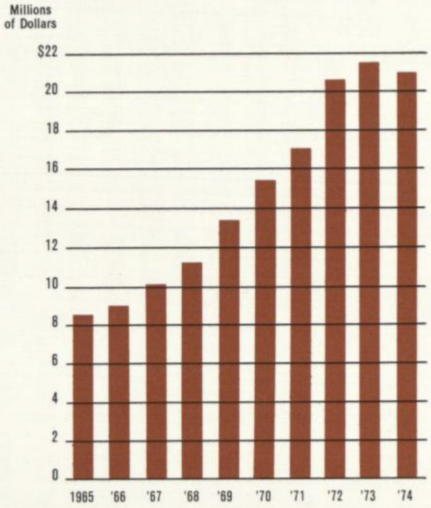
Sales in other than the Company's central downtown area stores accounted for 80% of the total net sales.

Sales for comparable stores (opened prior to February, 1973 with no appreciable change in square footage from that date) had an increase of 7.2%.

NET SALES



NET INCOME*



*NOT INCLUDING EXTRAORDINARY ITEMS.

Income

Net income from all operations for the year amounted to $21,034,000, a decrease of 2.7% over the record earnings of $21,625,000 for the prior year.

Per share earnings were $3.57. Last year the Company earned $3.67 per share.

In order to match more closely current costs with current revenues, the Company changed its method of accounting for inventory from first-in, first-out (FIFO) to last-in, first-out (LIFO). This was desirable because of the rapid increase in prices in 1974 which caused inventories sold to be replaced at substantially higher prices. The effect of this change was to decrease reported net income by $1,538,000, or 26¢ per share.

Net Income (thousands)

	1974*		1973		
Quarter	Amount	Per Share	Amount	Per Share	Inc. (Dec.) Per Quarter
1st	$ 4,037	$ .68	$ 3,546	$ .60	$ .08
2nd	3,762	.64	3,296	.56	.08
3rd	5,043	.86	5,006	.85	.01
4th	8,192	1.39	9,777	1.66	(.27)
	$21,034	$3.57	$21,625	$3.67	$(.10)

* restated to reflect LIFO inventory change

Income before Federal income taxes amounted to $40,229,000, representing 7.1% of sales, compared to $40,695,000, or 7.9% of sales, in 1973.

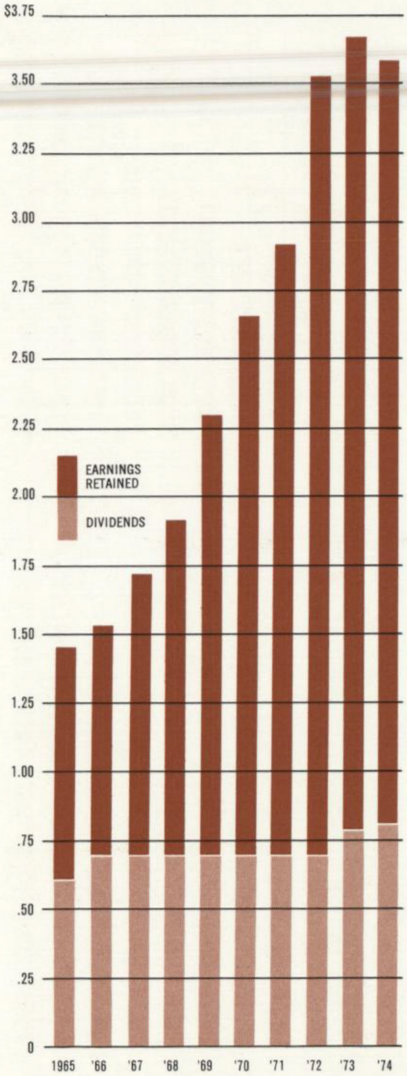
Although income was up by 8.4% on a restated basis at the end of the third quarter, it was evident that sales would soften considerably in the important last quarter, and that a program would have to be instituted immediately to bring inventories into line with the lower sales trend. At that point, inventories and outstanding orders were substantially higher than at the same time the previous year. Our drive to reduce inventories and outstanding orders was successful and we achieved our objective by year end. This inventory trend has continued through the month of March, 1975.

Our emphasis on lowering inventories resulted in higher markdowns which reduced fourth quarter income. We also believe that this concern with inventories adversely affected our sales volume in this quarter.

Fourth Quarter Results (thousands)

	1974	1973
Net Sales	$179,250	$175,323
Income Before Federal Income Taxes	$ 15,462	$ 18,397
Federal Income Taxes	7,270	8,620
Net Income	$ 8,192	$ 9,777
Net Income Per Share	$ 1.39	$ 1.66

INCOME*, DIVIDENDS AND
RETAINED EARNINGS*
PER SHARE OF STOCK



* NOT INCLUDING EXTRAORDINARY ITEMS.

Interest Expense

Interest expense for the year ended January 31, 1975 was $4,471,000, $295,000 less than the previous year.

The short term component of interest expense for the year was down by $450,000. Short term borrowings are used mainly to finance inventories and receivables as they build up for the peak Christmas season and to finance construction loans until permanent financing can be arranged, if required.

Less construction during 1974, reduction of the inventory during November and December and a nominal rise in receivables resulted in short term borrowings for a shorter period than in 1973. This reduced requirement was sufficient to offset the fact that short term rates were at historic highs.

We would expect that with the expansion underway for 1975 and 1976 and a more normal buildup of inventories and receivables during the last half of the year, there will be greater borrowings (both short and long term) which will cause interest expense to be higher in 1975.

Merchandising Policies

We have one overriding interest—running quality department stores in each of our locations. Although our stores may vary in size, primarily ranging from 60,000 to 200,000 square feet, they reflect a similar "character"—a personality to which our customers relate.

Our constant aim is to make our stores exciting places in which to shop and pleasant places in which to work for we are concerned about people on both sides of our counters.

Essentially, we are a family of local department stores, landmarks in our communities, but sharing in the growth of suburbia.

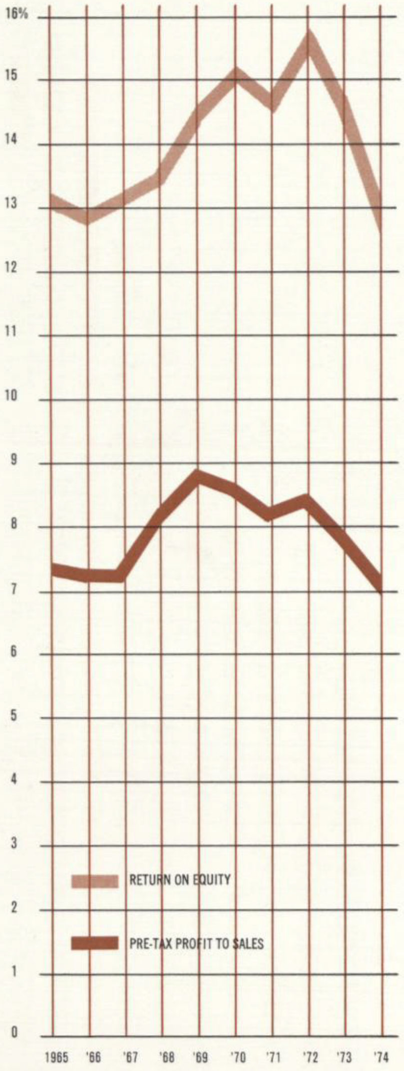
We offer our customers the best of two worlds—national brand and private label. We actively solicit and have been able to carry the most reputable national brands throughout our stores. However, in line with our desire to effectively compete with national chains, we have developed our own private label program. The important trade names owned by the Company include:

Merville
First Lady
Royal Knight
Royal Heir

We stress service to our customers at every level.

Related merchandise departments are located in proximity to one another—to maximize shopping convenience by enabling customers to select, coordinate and accessorize their wardrobes.

PERCENTAGE OF PRE-TAX PROFIT TO SALES AND RETURN ON EQUITY*



*BASED ON AVERAGE INVESTMENT

Our policy in regard to returns and exchanges is liberal in the extreme. Making a return is as easy as making a purchase.

In conjunction with our desire to serve, we operate our own beauty salons in most stores. Many of our stores have restaurants and, lately, we have added departments such as picture framing and live flowers.

Your Company has been able to blend successfully chain store centralization with local store autonomy. Local autonomy permits the stores to operate as independent retailers, integral parts of their communities, sensitive to the needs and wants of their customers and able to respond immediately. The critical decisions—what to order, when and how much—are made as close to the customer as possible.

To assist the stores in these critical decisions, the Company maintains a buying office in New York which has continuous contact with all of the other major markets (such as Los Angeles, Dallas, Miami and Chicago). It keeps up-to-date on the latest fashions, analyzes trends and speeds this information along with merchandising recommendations to the stores.

The New York office has responsibility for purchasing all private label merchandise sold throughout the Company. Department managers from the stores attend periodic merchandise committee meetings in New York at which time Company programs are developed. No merchandising program is ever considered final until it has been reviewed by a store committee.

We also have a staff in New York handling our import program. They make frequent and regular trips to Asia, South America and Europe (some 25 countries) to find that which is different, distinctive and exciting.

We have been able to perform many functions centrally. Such activities include:

Accounting
Credit
Data Processing
Insurance
Real Estate
Store Planning
Supply Purchasing
Taxes
Traffic

By centralizing these activities, we can assign personnel with specialized training and realize substantial economies.

Personnel Policies

Our long established programs of recruitment, training and promotion from within have developed personnel with the qualities of leadership and talent vital to our continued growth in the decades ahead. We seldom go outside the Company to fill a position of responsibility and we rarely lose a key employee. An environment exists which encourages people to develop themselves, for their growth and the Company's are closely interrelated.

We offer many benefit programs. These programs are being constantly reviewed and improved so that we may be as competitive in our personnel policies as we are in our merchandising policies.

We have a comprehensive life and hospitalization program for all our employees and their dependents, including major medical coverage for catastrophic losses. During this past year, we expanded our program to include dental coverage as well.

In past years, we have reported extensively on our Savings and Profit Sharing Plan. Our employees contribute a percentage of their remuneration to a fund which invests in securities managed by Chemical Bank. The Company makes a partial matching of such contribution from its profits. In this latest year, the Company contributed 73¢ for each $1.00 contributed, up to 6% of total remuneration.

The Company has had a Pension Plan, managed by First National City Bank, in effect since 1945. We are in the process of extensively reviewing the provisions of this plan as they relate to the Pension Reform Act of 1974.

Expenses

An important element of our success for many years has been the control exercised over our expenses. In the last ten years the expense ratio to sales has not fluctuated by more than 1½%.

Our increasing profitability in the past decade has not lulled us into complacency about expenses. During these demanding times when sales are sluggish, we do not have to embark upon crash programs of expense reduction.

Receivables and Credit

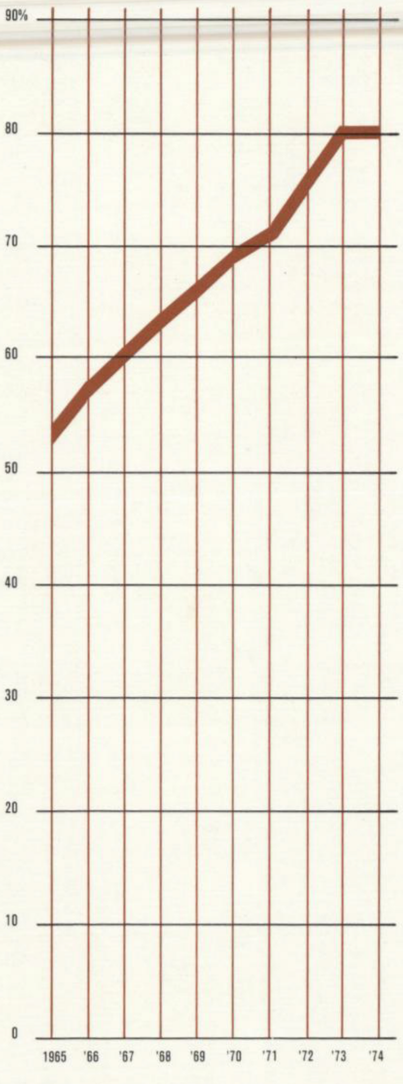
Another aspect of our business which deserves more than passing mention has been the handling of our receivables.

We have always prided ourselves on the quality rather than the quantity of our receivables. It has been achieved only through years of careful and constant review of our customer accounts and our standards for granting credit. The exercise of these policies has resulted in a low bad debt loss record and a more current condition of our accounts.

Receivables (in thousands) were as follows:

	January 31,	
	1975	1974
Customer Accounts		
Regular Retail	$ 8,697	$10,426
Revolving Charge	49,629	47,189
Installment	9,535	9,130
	$67,861	$66,745
Less: Reserve for Doubtful Accounts	(3,739)	(3,671)
Accounts Sold to Mersco Finance Corporation Net of Retained Equity of $6,061,000 and $5,775,000, respectively	(54,545)	(51,975)
Customer—Net	$ 9,577	$11,099
Other	5,069	2,861
Receivables—Net	$14,646	$13,960

SUBURBAN STORE SALES
% OF TOTAL SALES



Store Growth

During the year, the Company doubled the size of its Edgewater, Mississippi and Tuscaloosa, Alabama stores, which are operated under the Gayfers name, from 80,000 to 160,000 square feet each. In addition to these expanded units, the Company's Castner-Knott division opened a 25,000 square foot store, specializing in clothing, in Franklin, Tennessee on October 10, 1974.

The Company closed a small store (19,300 square feet) in Pittsburg, Kansas at the end of December, 1974.

During 1975, we plan to open four stores, as follows:

Location	Square Footage	Opening
Middletown, Ohio	108,000	February, 1975
Columbus, Georgia	144,000	August, 1975
Federal Way, Washington	93,600	August, 1975
Billings, Montana	93,600	September, 1975

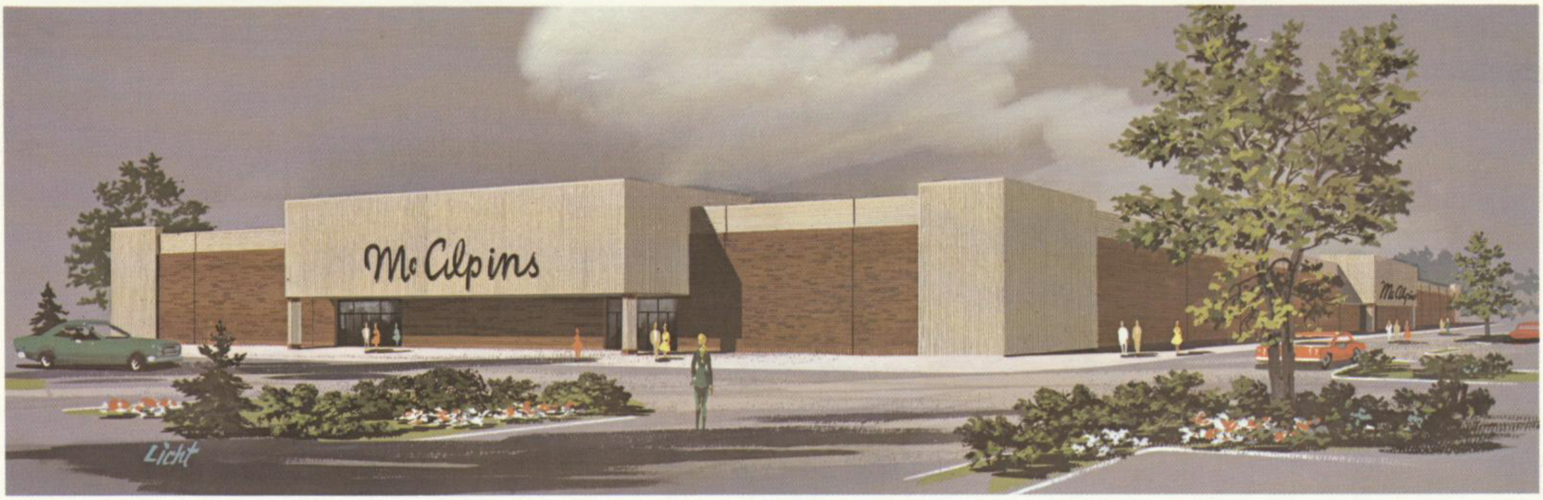
The smaller unit (40,000 square feet) at Middletown, Ohio was closed at the end of January, 1975 and its replacement opened February 3, 1975.

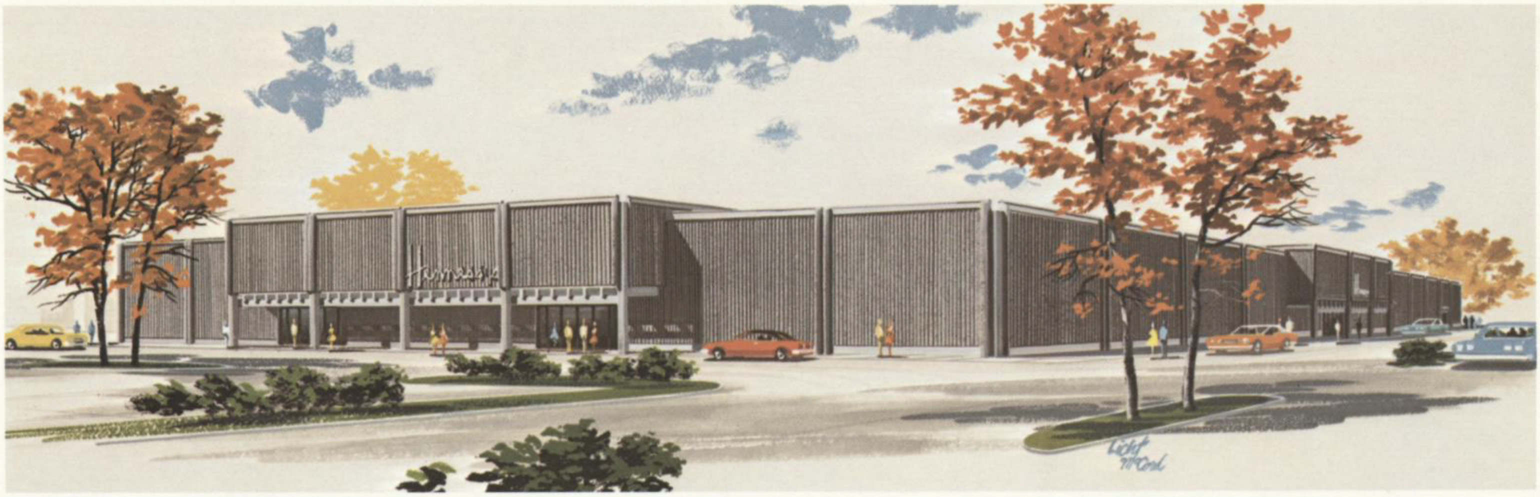
The Company is planning on four stores in 1976 with combined square footage of 540,000 and a possible expansion of 60,000 square feet in an existing unit. One of the stores planned for 1976 will replace a similar sized store.

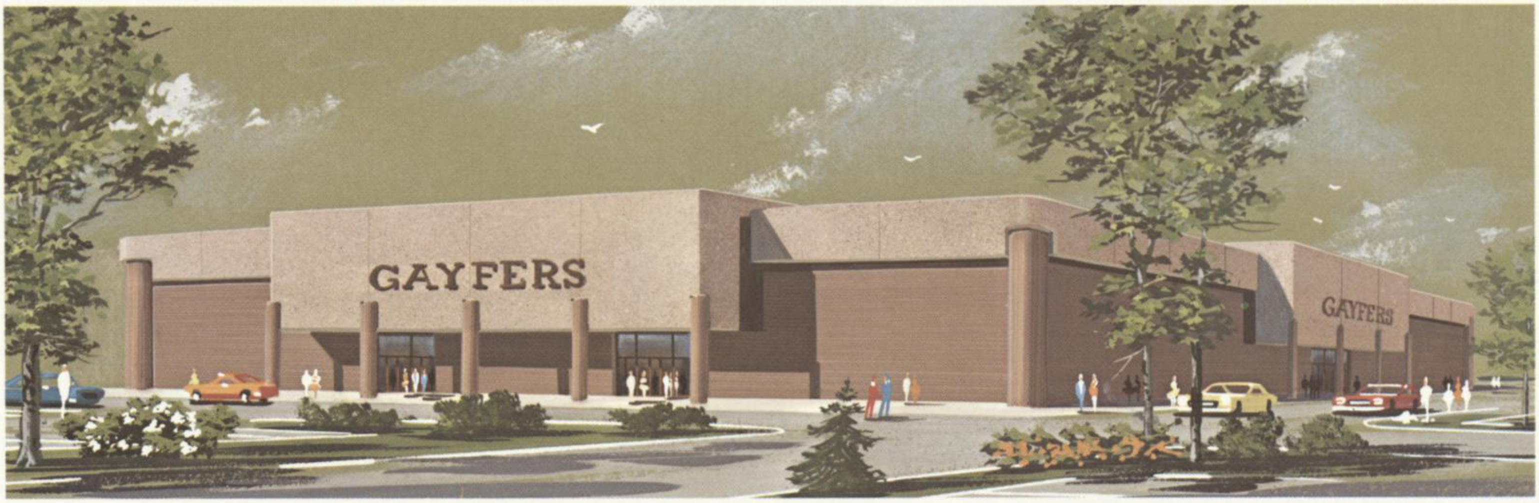
In 1974, the Company expended $22,556,000 for plant and equipment which was approximately $6,500,000 higher than the previous year. Of this total, approximately $17,100,000 was spent on projects completed in 1974 and the balance was for plant and equipment that will not be placed in service until 1975.

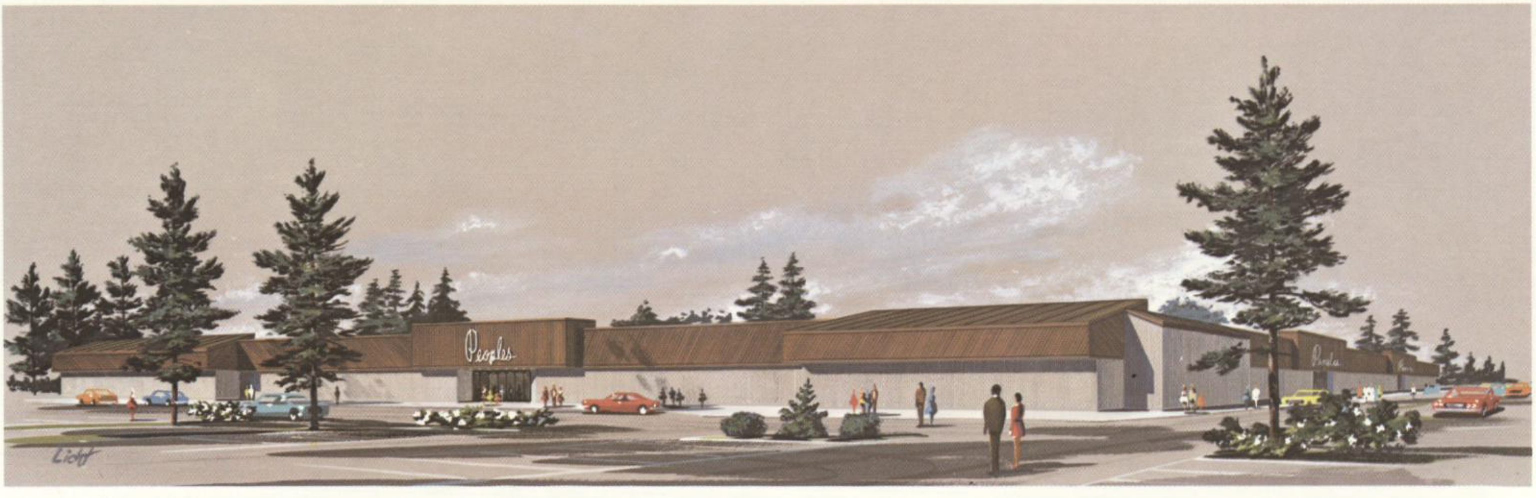
New Stores

Middletown, Ohio
Billings, Montana
Columbus, Georgia
Federal Way, Washington


McAlpins
McAlpins
Licht


Hennessy's
Licht
McCord


GAYFERS
GAYFERS


Peoples
Peoples
Licht

Planned capital expenditures for the new year have been budgeted at $30,000,000 of which $19,000,000 will be used to complete projects in 1975 and $11,000,000 for new stores and an expansion contemplated for 1976.

Depreciation on a straight-line basis totaled $10,173,000 for the year, an increase of $640,000 over that recorded in 1973.

In line with our effort to present attractive stores, we spent $2,290,000 for maintenance and repairs.

Management Changes

In August, 1974, Mr. R. Nelson Shaw announced that he would step down as Chairman of the Board and as a Member of the Executive Committee for reasons of health.

Mr. Shaw began his career with the Company in 1935 and his contribution is immeasurable. We are pleased to have Mr. Shaw continue as a Director of the Company.

Mr. Leon F. Winbigler who, as President, became Chief Executive Officer upon Mr. Shaw's resignation, became Chairman of the Board in December, 1974.

Mr. James C. Lovell, 48, was appointed President at this same time. Mr. Lovell has been with the Company for 31 years. His latest assignment was as President of our Castner-Knott Division in Tennessee.

Bacons—Retailer in the Bluegrass State

Our special report this year features Bacons which has shown a remarkable growth in the last few years after the closing of our downtown store in Louisville, Kentucky and the opening of a 185,000 square foot store in Bashford Manor.

Recent Trend

Sales for February increased by 3.9%. March was up by 5.4% for a year-to-date increase of 4.8%.

We wish to express our gratitude to the thousands of dedicated employees who, through their efforts and loyalty, have contributed so much to the progress of the Company.

Respectfully submitted,

L. F. Winbigler

Leon F. Winbigler,
Chairman of the Board

J. C. Lovell

James C. Lovell,
President

By Order of the Board of Directors

Financial Statements

Auditors' Report

To the Stockholders and Board of Directors of
Mercantile Stores Company, Inc.:

We have examined the consolidated balance sheets of Mercantile Stores Company, Inc. (a Delaware corporation) and subsidiary companies as of January 31, 1975 and 1974, and the related statements of consolidated income and retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Mercantile Stores Company, Inc. and subsidiary companies as of January 31, 1975 and 1974, and the results of their operations and the changes in financial position for the years then ended, in conformity with generally accepted accounting principles which, except for the change, with which we concur, to the last-in, first-out method of determining inventory costs as indicated in Note 1 to the consolidated financial statements, were consistently applied during the periods.

Arthur Andersen & Co.

New York, N. Y.,
April 10, 1975.

Statements of Consolidated Income and Retained Earnings

	For the years ended January 31, 1975	1974
Net Sales	$563,861,000	$518,106,000
Costs and Expenses:		
Cost of goods sold (including occupancy expenses)	392,038,000	357,203,000
Selling, general and administrative expenses	127,123,000	115,442,000
Interest expense	4,471,000	4,766,000
	523,632,000	477,411,000
Income Before Federal Income Taxes	40,229,000	40,695,000
Federal Income Taxes—Note 2		
Currently payable	17,770,000	16,854,000
Deferred	1,425,000	2,216,000
	19,195,000	19,070,000
Net Income	$ 21,034,000	$ 21,625,000
Retained Earnings at beginning of year	145,154,000	128,098,000
	166,188,000	149,723,000
Cash Dividends declared and paid $.80 and $.77½ per share, respectively	4,716,000	4,569,000
Retained Earnings at end of year	$161,472,000	$145,154,000
Net Income per common share	$3.57	$3.67

See Notes to Consolidated Financial Statements.

Statements of Consolidated Changes in Financial Position

	For the years ended January 31,	
	1975	1974
Sources of Working Capital:		
Net income	**$21,034,000**	$ 21,625,000
Depreciation	**10,173,000**	9,533,000
Increase in deferred income taxes	**1,585,000**	1,146,000
Funds provided from operations	**32,792,000**	32,304,000
Increase in long-term debt	**3,300,000**	—
Reduction (increase) of other investments	**113,000**	(131,000)
Total	**36,205,000**	32,173,000
Dispositions of Working Capital:		
Dividends paid	**4,716,000**	4,569,000
Additions to property and equipment	**22,556,000**	16,072,000
Reduction in long-term debt	**1,443,000**	1,444,000
Increase in equity in and advance to Mersco Finance Corporation	**557,000**	2,967,000
Total	**29,272,000**	25,052,000
Increase in Working Capital	**$ 6,933,000**	$ 7,121,000
Changes in Working Capital:		
Current assets		
Cash	**$ 2,240,000**	($ 422,000)
Receivables	**686,000**	(4,265,000)
Due from Mersco Finance Corporation	**2,172,000**	18,764,000
Inventories	**(4,336,000)**	7,164,000
Prepayments and other	**(245,000)**	(162,000)
Total	**517,000**	21,079,000
Current liabilities		
Accounts payable	**(2,494,000)**	4,034,000
Accrued liabilities	**(201,000)**	3,391,000
Federal income taxes	**(3,729,000)**	5,514,000
Deferred income taxes on installment sales	**9,000**	1,004,000
Debt due within one year	**(1,000)**	15,000
Total	**(6,416,000)**	13,958,000
Increase in Working Capital	**$ 6,933,000**	$ 7,121,000

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

	January 31,	
ASSETS		
Current Assets:	**1975**	1974
Cash	**$ 12,015,000**	$ 9,775,000
Receivables — See page 7	**14,646,000**	13,960,000
Due from Mersco Finance Corporation — Note 8	**49,429,000**	47,257,000
Inventories — Note 1	**82,803,000**	87,139,000
Prepayments and other	**1,872,000**	2,117,000
Total Current Assets	**160,765,000**	160,248,000
Other Investments	**2,121,000**	2,234,000
Equity in and Advance to Mersco Finance Corporation—Note 8	**4,697,000**	4,140,000
Property and Equipment, at cost:		
Land	**10,082,000**	8,278,000
Buildings and improvements	**89,987,000**	78,944,000
Fixtures	**61,548,000**	56,788,000
	161,617,000	144,010,000
Less accumulated depreciation	**55,327,000**	50,103,000
Property and Equipment — Net	**106,290,000**	93,907,000
Total	**$273,873,000**	$260,529,000

See Notes to Consolidated Financial Statements.

LIABILITIES AND STOCKHOLDERS' EQUITY	January 31, 1975	1974
Current Liabilities:		
Accounts payable	$ 30,727,000	$ 33,221,000
Accrued liabilities	15,531,000	15,732,000
Federal income taxes	2,791,000	6,520,000
Deferred income taxes on installment sales	8,092,000	8,083,000
Debt due within one year	1,443,000	1,444,000
Total Current Liabilities	58,584,000	65,000,000
Long-Term Debt — Note 4	34,656,000	32,799,000
Deferred Income Taxes applicable to depreciation	7,612,000	6,027,000
Stockholders' Equity:		
Common stock — $.91 2/3 par value issued 5,901,996, outstanding 5,895,636 shares (after deducting 6,360 treasury shares)	5,404,000	5,404,000
Capital surplus	6,145,000	6,145,000
Retained earnings — Note 5	161,472,000	145,154,000
Stockholders' Equity	173,021,000	156,703,000
Total	$273,873,000	$260,529,000

Notes to Consolidated Financial Statements

1) Summary of Significant Accounting Policies

a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries except for Mersco Finance Corporation. All intercompany accounts and transactions have been eliminated. The Company's investment in the finance subsidiary is carried at equity in its net assets.

Substantially all of the income before income taxes of Mersco Finance Corporation has been reflected in the Statements of Consolidated Income as a reduction of interest expense.

The consolidated statements include the equity in the earnings of affiliated companies owned 20% or more, which are joint ventures of the real estate subsidiaries.

The net current assets and results of operations of Canadian subsidiaries are included in the consolidated financial statements in terms of U. S. dollars at current rates of exchange. No material exchange gains or losses were recognized in either year.

b) Inventory Pricing

As of February 1, 1974, the Company adopted the last-in, first-out (LIFO) method of determining inventory cost for all domestic retail inventories. It had previously used the first-in, first-out (FIFO) method. The new method is considered preferable because it more closely matches current costs with current revenues in periods of rising prices.

This change in the method of accounting for inventories had the effect of reducing net income for the year 1974 by $1,538,000, or $.26 per share, below that which would have been reported using the Company's previous inventory pricing method. The pro-forma effects on 1973 net income and net income per share are not reflected because the effect of this accounting change on the prior period is not determinable.

The LIFO inventory amount at January 31, 1975 was $3,128,000 less than that which would have been reported on a FIFO inventory basis.

c) Accounts Receivable

Installment receivables maturing more than one year after January 31, 1975 and 1974 have been included in current assets in conformity with the usual practice followed by department store companies. Profit on installment sales is taken into income at the time of sale; carrying charges are recognized over the term of the installment contracts.

d) Depreciation

Buildings, improvements and fixtures are depreciated on a straight-line basis for book purposes. Accelerated depreciation is used for income tax purposes.

e) Store Pre-Opening Expenses

Store pre-opening expenses are charged to income in the year the expenses are incurred.

2) Income Taxes

Deferred tax expense results from timing differences in the recognition of revenue and expense for tax and financial statement purposes. The sources of these differences and the tax effect of each were as follows:

	(thousands) 1974	1973
Excess of tax over book depreciation	$ 1,420	$ 1,077
Income deferred for tax purposes on installment sales to customers but recognized as income on the books	5	1,139
	$ 1,425	$ 2,216

In both years total tax expense was slightly less than the amount computed by applying the U.S. Federal income tax rate of 48% to income before tax. The only significant reason for these differences was the investment tax credits of $570,000 in 1974 and $785,000 in 1973, which are treated as a current reduction of Federal income taxes.

3) Short-Term Indebtedness

The Company maintains an open line of credit with First National City Bank under which it can borrow up to a total of $25,000,000 at the bank's prime rate of interest. During the current fiscal year, the Company did not find it necessary to avail itself of this line of credit.

Mersco Finance Corporation has a credit agreement with First National City Bank under which it can borrow up to $12,000,000 through January 31, 1977. Any amount outstanding at that date is to be paid in 16 substantially equal quarterly installments commencing April 30, 1977.

In addition, Mersco Finance Corporation maintains a $30,000,000 line of credit with First National City Bank. These borrowings are evidenced by unsecured notes, payable on demand.

The average monthly short-term borrowings for the years ended January 31, 1975 and January 31, 1974 were $14,501,000 and $20,958,000 at weighted average interest rates of 11.3% and 8.6%, respectively. The maximum outstanding for any month end for 1974 and 1973 was $29,000,000 and $31,000,000. A commitment fee of $14,800 and $5,000 in 1974 and 1973, respectively, based on ½ of 1% per annum of the daily unused portion of the commitment was charged under the $12,000,000 agreement. At January 31, 1975, all borrowings under these arrangements had been repaid.

The Company has an informal understanding with First National City Bank that it will maintain average collected balances in its accounts with the bank of 10% of the total available borrowings ($67,000,000). An additional 10% will be maintained for any sums borrowed in excess of $33,500,000. The average collected balances exceeded the average book balances during the year by approximately $3,000,000 due to the excess of unpresented checks over uncollected deposits. Accordingly, an average of approximately $3,700,000 of cash included in the Company's books was maintained in support of this arrangement. The lines of credit, but not the credit agreement, may be withdrawn at the option of the bank.

4) Long-Term Debt

Long-term debt consisted of the following:

	January 31, (thousands)	
	1975	1974
8.70% Sinking Fund Debentures due 1995	$ 25,000	$ 25,000
5⅛% Notes due 1978—$333,000 due annually, $338,000 due December 1, 1977, with $2,500,000 due December 1, 1978	3,504	3,837
6% to 7.10% Capitalized Lease Obligation	3,300	—
4% to 6⅛% Mortgage Notes — generally payable quarterly over the life of the mortgage	4,295	5,406
	$ 36,099	$ 34,243
Less—due within one year	1,443	1,444
	$ 34,656	$ 32,799

The only additional long-term debt incurred by the Company and its consolidated subsidiaries during 1974 was the capitalized lease obligation indicated above. Under the lease arrangement, a warehouse, including land, building, fixtures and equipment with an original cost of approximately $3,300,000, was constructed by an Authority with funds provided from the sale of Industrial Development Revenue Bonds. The bonds mature in annual amounts ranging from $60,000 in 1975 to $260,000 in 1999. The lease payments coincide with and are equal to the principal and interest payments on the bonds. The Company has the option to purchase the warehouse at any time subsequent to December 1, 1984 at redemption prices which start at 103% of the face value of the then outstanding bonds and decrease on a scheduled basis to 100% of face value for any redemption made subsequent to December 1, 1997. This transaction has been treated as a purchase for financial reporting purposes.

Maturities on long-term debt for the next five years are as follows:

Year Ending	(thousands) Amount
January 31, 1976	$ 1,443
January 31, 1977	2,529*
January 31, 1978	2,224*
January 31, 1979	4,186*
January 31, 1980	1,668*

* Includes annual sinking fund payment of $1,250 commencing December 1, 1976.

5) Retained Earnings

Under a loan agreement with an insurance company, payment of cash dividends on the common stock is limited to 70% of consolidated net income (as defined) subsequent to January 31, 1958. At January 31, 1975, the earnings free from this restriction were $64,272,000.

6) Pension & Profit Sharing Plans

The Company contributes to a Pension Plan covering substantially all of its employees who have met certain age and experience requirements. Accrued pension costs are funded currently and unfunded prior service costs of $2,300,000, as of the latest actuarial report, are being amortized over ten years. The Company also contributes to an employees' Savings and Profit Sharing Plan.

The expenses of the Company for the past two years were as follows:

	(thousands) 1974	1973
Pension	$ 2,631	$ 2,325
Savings & Profit Sharing	2,050	1,921
	$ 4,681	$ 4,246

Provisions of the Pension Reform Act of 1974, which will become effective in 1976, will require the Company to amend its Pension Plan which will have the effect of increasing the cost of benefits provided to participants. It is not practicable at the present time for the Company to determine the effect of the resulting increase on annual pension expense or the funding of pension costs for 1976 and subsequent years or on unfunded vested benefits.

7) Leases and Commitments

The Company had 120 leases in effect at January 31, 1975, most of which will expire during the next twenty years. In the normal course of business, it is expected that many of them will be renewed or replaced by leases on other properties.

The Company has classified its lease commitments as either "financing" leases or "operating" leases. In general, a financing lease is defined as a lease which during the noncancelable period, either (1) covers 75% or more of the economic life of the property or (2) has terms which assure the lessor full recovery of the fair market value of the property plus a reasonable return.

Rent expense on leases, primarily real estate, was as follows (in thousands):

	1974		
	Financing Leases	Operating Leases	Total
Minimum Rentals	$ 4,523	$ 1,474	$ 5,997
Contingent Rentals	1,019	168	1,187
Total Rent Expense	$ 5,542	$ 1,642	$ 7,184

	1973		
	Financing Leases	Operating Leases	Total
Minimum Rentals	$ 4,062	$ 1,427	$ 5,489
Contingent Rentals	1,030	145	1,175
Total Rent Expense	$ 5,092	$ 1,572	$ 6,664

Contingent Rentals are based on percentages of sales.

The future minimum annual lease commitments on noncancelable leases in effect at January 31, 1975, (in thousands), were as follows:

Fiscal Years Ending January 31,	Financing Leases	Operating Leases	Total
1976	$ 5,306	$ 1,141	$ 6,447
1977	5,283	985	6,268
1978	5,273	908	6,181
1979	5,246	716	5,962
1980	5,246	632	5,878
1981-85	25,905	1,674	27,579
1986-90	22,429	332	22,761
1991-95	16,420	83	16,503
After 1995	14,244	775	15,019
	$ 105,352	$ 7,246	$ 112,598

Many of the leases require additional payments for real estate taxes and insurance, in addition to the contingent rentals.

The present values of the aggregate minimum lease commitments relating to the financing leases computed on a net lease basis and the interest rates used in the computation were as follows:

Range of Interest Rates Used in the Present Value Computation	Weighted Average Interest Rate Year Ending January 31,		Present Value of Rentals At January 31, (thousands)	
	1975	1974	1975	1974
4.50-9.88%	7.60%	7.46%	$ 36,843	$ 36,394

If the financing leases were capitalized, with the lease rights amortized on a straight-line basis and interest expense accrued on the outstanding lease liability, net income for the years ended January 31, 1975 and January 31, 1974 would not have been materially affected.

8) Mersco Finance Corporation

The Company sells its revolving and installment sales accounts to its finance subsidiary, Mersco Finance Corporation, without recourse. Mersco withholds, as a reserve, an amount equal to 10% of the receivables acquired. Mersco currently charges the Company a fee which is equal to one and one half times its fixed charges.

The following are summary balance sheets for Mersco Finance Corporation:

	January 31, (thousands) 1975	1974
Assets		
Customer receivables purchased from Mercantile Stores Company, Inc.	$ 60,606	$ 57,587
Equity in customer receivables sold (uncollected balances of $163,000 in 1974)	—	16
Less—Amount payable to Mercantile Stores Company, Inc. pending collection of customer receivables	(6,061)	(5,775)
	54,545	51,828
Cash	17	16
Total Assets	$ 54,562	$ 51,844
Liabilities and Stockholder's Equity		
Current Liabilities		
Due to Mercantile Stores Company, Inc.	$ 49,429	$ 47,257
Due to bank	—	41
Federal income taxes	273	291
Accrued liabilities	163	115
	49,865	47,704
Long-Term Note, due to an affiliate	2,500	2,500
Stockholder's Equity	2,197	1,640
Total Liabilities and Stockholder's Equity	$ 54,562	$ 51,844

Ten-year Summary of Operations

Year ended January 31	1975	1974	1973
Operating Results			
Net sales	**$563,861,000**	$518,106,000	$458,328,000
Cost of sales	**392,038,000**	357,203,000	314,682,000
Selling, general and administrative expenses	**127,123,000**	115,442,000	100,363,000
Interest expense	**4,471,000**	4,766,000	4,127,000
Income before Federal income taxes	**40,229,000**	40,695,000	39,156,000
Percent to sales	**7.1**	7.9	8.5
Federal income taxes	**19,195,000**	19,070,000	18,400,000
Income before extraordinary item	**21,034,000**	21,625,000	20,756,000
Percent to sales	**3.7**	4.2	4.5
Extraordinary item	**—**	—	—
Dividends paid	**4,716,000**	4,569,000	4,127,000
Per Common Share (1)			
Income before extraordinary item	**$ 3.57**	$ 3.67	$ 3.52
Extraordinary item	**—**	—	—
Dividends	**.80**	.77½	.70
Financial Position			
Working capital	**$102,181,000**	$ 95,248,000	$ 88,127,000
Ratio of current assets to current liabilities	**2.74**	2.47	2.73
Receivables—before deduction for accounts sold	**69,191,000**	65,935,000	65,473,000
Inventories	**82,803,000**	87,139,000	79,975,000
Property and equipment — net	**106,290,000**	93,907,000	87,368,000
Total assets	**273,873,000**	260,529,000	229,813,000
Long-term debt	**34,656,000**	32,799,000	34,243,000
Retained earnings	**161,472,000**	145,154,000	128,098,000
Stockholders' equity	**173,021,000**	156,703,000	139,647,000
Per common share	**29.35**	26.58	23.69
Return on stockholders' equity (2)	**12.8%**	14.6%	15.8%
Number of shares outstanding (1)	**5,895,636**	5,895,636	5,895,636
Other Data			
Capital expenditures	**$ 22,556,000**	$ 16,072,000	$ 19,766,000
Depreciation	**10,173,000**	9,533,000	7,557,000
Number of stores	**71**	72	71
Total square feet	**7,538,000**	7,372,000	6,863,000

(1) Amounts have been adjusted for 2 for 1 split in year ended January 31, 1974.

(2) Based on average of stockholders' equity at beginning and end of year.

1972	1971	1970	1969	1968	1967	1966
$393,258,000	$353,464,000	$318,353,000	$285,585,000	$256,550,000	$234,267,000	$220,610,000
269,943,000	241,855,000	218,513,000	197,832,000	180,822,000	165,650,000	156,346,000
86,943,000	78,043,000	69,015,000	61,780,000	55,181,000	49,631,000	46,380,000
3,731,000	3,186,000	2,503,000	2,207,000	1,816,000	1,940,000	1,619,000
32,641,000	30,380,000	28,322,000	23,766,000	18,731,000	17,046,000	16,265,000
8.3	8.6	8.9	8.3	7.3	7.3	7.4
15,390,000	14,700,000	14,760,000	12,415,000	8,549,000	7,972,000	7,665,000
17,251,000	15,660,000	13,562,000	11,351,000	10,182,000	9,074,000	8,600,000
4.4	4.4	4.3	4.0	4.0	3.9	3.9
—	1,007,000	—	—	1,387,000	—	—
4,127,000	4,127,000	4,127,000	4,127,000	4,127,000	4,127,000	3,537,000
$ 2.93	$ 2.66	$ 2.30	$ 1.93	$ 1.73	$ 1.54	$ 1.46
—	.17	—	—	.24	—	—
.70	.70	.70	.70	.70	.70	.60
$ 84,153,000	$85,501,000	$ 57,414,000	$ 52,679,000	$ 46,387,000	$ 43,829,000	$ 41,147,000
3.14	3.27	2.75	2.66	2.80	2.79	2.57
52,673,000	47,740,000	43,807,000	41,615,000	38,309,000	35,949,000	34,748,000
65,422,000	57,975,000	50,321,000	46,017,000	39,757,000	33,325,000	32,179,000
76,538,000	63,052,000	54,622,000	52,171,000	48,319,000	44,157,000	42,031,000
201,885,000	188,844,000	146,898,000	137,726,000	121,909,000	113,949,000	111,387,000
35,819,000	37,268,000	14,102,000	15,731,000	13,526,000	14,572,000	15,858,000
111,469,000	98,345,000	85,785,000	76,350,000	69,126,000	61,684,000	55,705,000
123,018,000	109,894,000	97,334,000	87,899,000	80,675,000	73,234,000	67,255,000
20.87	18.64	16.51	14.91	13.68	12.42	11.41
14.8%	15.1%	14.6%	13.5%	13.2%	12.9%	13.2%
5,895,636	5,895,636	5,895,636	5,895,636	5,895,636	5,895,636	5,895,636
$ 20,496,000	$ 14,178,000	$ 7,970,000	$ 8,178,000	$ 8,634,000	$ 6,887,000	$ 4,560,000
6,235,000	5,182,000	4,613,000	4,326,000	3,983,000	3,485,000	3,243,000
69	66	62	61	61	60	58
6,256,000	5,656,000	5,134,000	5,005,000	4,942,000	4,630,000	4,427,000

Comments

Scope of Business

The Company operates 71 department stores in the downtown and suburban areas of cities in 18 states in the United States and in the Province of Ontario, Canada. The Company does not operate stores in the very large metropolitan areas. All stores operate under locally prominent trade names and stress a wide selection of goods and a high degree of service. A listing of the names and locations of the stores is shown on pages 28 and 29 of this report.

The department store business is highly competitive, as similar merchandise is generally available to competitors at the same cost price. The Company believes that its pricing policies are competitive with other stores in the areas in which it operates. The Company competes with department, specialty and discount stores, including national chains, in the purchase and sale of merchandise, as well as for store location sites.

As is the case in the department store industry, the fourth quarter, which encompasses the Christmas selling season, is the most significant period of the year for the Company. In the year ended January 31, 1975, the fourth quarter accounted for 32% of total net sales and 39% of total net income.

All of the Company's stores carry a wide assortment of goods ranging from higher priced nationally branded items to more moderately priced goods sold under the Company's private label although each store tailors its particular mix of goods to the needs of its customers. In general, the stores attempt to appeal to middle-to-upper income groups. All of the stores are designed to present an attractive setting to the customer while emphasizing both fashion and value.

The Company employs approximately 12,500 people on a regular basis and up to 16,500 during peak periods.

Management's Discussion of Summary of Operations

Sales in the 1974 fiscal year increased by 8.8% as compared to an increase of 13.0% in 1973 and 16.5% in 1972. As explained in the Letter to the Stockholders, the expansion in the 1974 fiscal year was much less than that in the two previous years. In addition, the emphasis on reducing inventories during the fourth quarter of 1974 undoubtedlly had an adverse effect on sales volume.

Cost of Sales in the 1974 fiscal year increased in dollars by 9.8%. This was slightly higher than the increase in sales for this same period and was primarily due to the conversion to the LIFO method of inventory valuation. In 1973, Cost of Sales increased by 13.5%, slightly higher than the sales increase, as a result of Phase IV regulations. The increase in Cost of Sales for the 1972 fiscal year of 16.6% corresponded to the sales increase.

Selling, General and Administrative Expenses increased by 10.1% in the latest year and by 15.0% in the prior year, which were higher than the sales increases. Advertising, supplies, payroll taxes and medical insurance were the primary causes of the increases.

Interest Expense was down by 6.2% in the 1974 fiscal year which, as explained in the Letter to the Stockholders, was attributable to the reduced amount of short term borrowings. Interest Expense in 1973 reflected normal borrowing levels and higher than usual rates for short term borrowings while, in 1972, the large increase in profitability and the switch to installment reporting of receivables for tax purposes helped the cash flow of the Company and mitigated the need for normal borrowings.

Market and Dividend Information

The Company has only one class of stock outstanding—common, with a par value of $.91 2/3 per share. This stock is traded on the New York Stock Exchange.

The range of closing market prices by quarter for the last two years was as follows:

1974

Quarter	High	Low
First	41	35⅛
Second	45	37
Third	40	28¼
Fourth	38⅜	28¼

1973*

Quarter	High	Low
First	85½	78⅜
Second	79¾	54
Third	76	66
Fourth	66⅝	36¼

During the past two years, the following dividends were paid for each share of stock:

March 15, 1974	$ .20
June 14, 1974	.20
September 14, 1974	.20
December 13, 1974	.20
	$ .80
March 15, 1973	$ .17½ *
June 15, 1973	.20
September 15, 1973	.20
December 14, 1973	.20
	$ .77½

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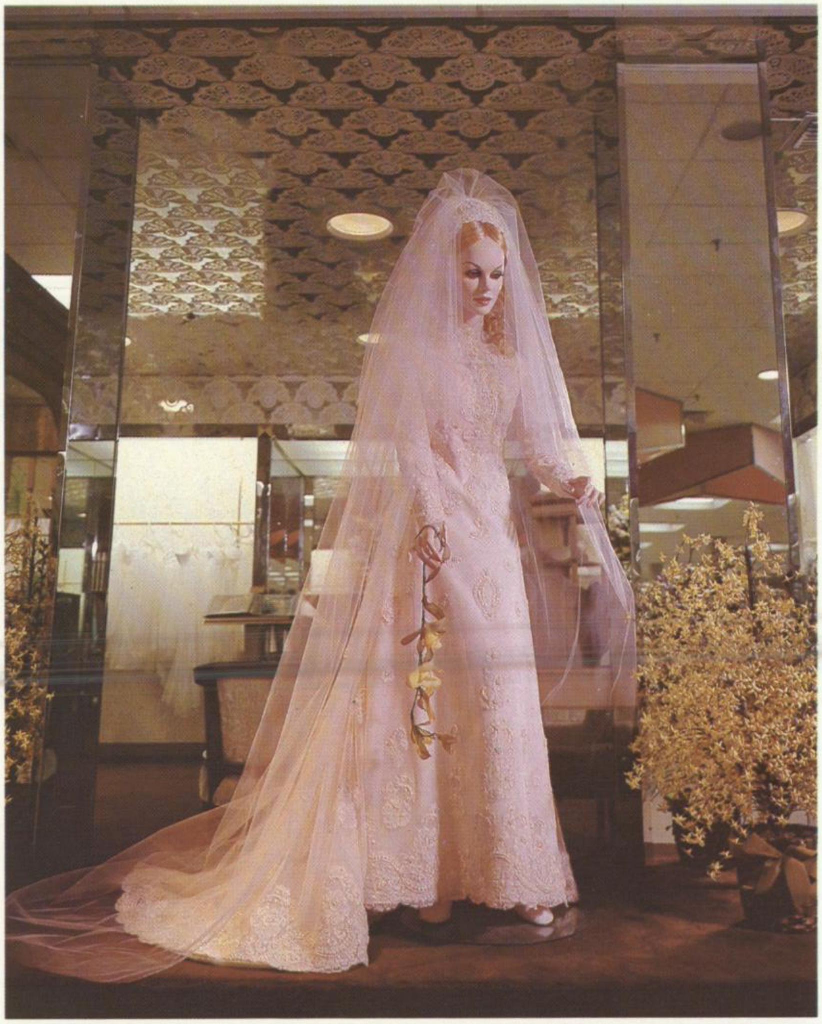
* Adjusted for 2 for 1 stock split



Bacons

Retailer in the Bluegrass State

Bacons has been a vital part of the commercial life of Louisville for 130 years. It was founded in 1845 by Jeremiah Bacon, an enterprising young man who, before deciding on a location for his store, made a careful survey of all the turnpikes and roads which led into the city from the east. Armed with that bit of early market research, he opened J. Bacon & Sons in a spot where it would be sure to attract the most traffic.

As the stagecoaches and private carriages gave way to Louisville's first public street railways, Jeremiah's little retail business was so prosperous that he soon found it necessary to add several stories to the original store. Then, in 1876, he built an imposing duplicate addition to the old store and merged the old and new together into one, large emporium. He now began a thriving wholesale trade as well.

In time, the business outgrew even these quarters and a new, more spacious department store was built on Market and Fourth and opened in 1901. Jeremiah Bacon's three sons, who were now running the company, found the big organization irksome, sold the store and retired from retailing in 1903.

Bacons was one of the original properties acquired by the Company from the H. B. Claflin Company in 1914.

Shortly after World War II, Louisville, now one of the nation's leading river ports and transportation centers, rapidly expanded into suburban locations. Bacons saw the need for suburban stores and opened its first

designer
room

JOHN MEYER

HOME FASHION
CONSULTANT

branch store (72,000 square feet) at St. Matthews in 1954. Four years later, Bacons opened a new 75,000 square foot branch at Shively in the Bacons Shopping Center. Bacons moved across the state line into Indiana in 1960 to open a new store in Jeffersonville.

For the next twelve years, the Bacon group continued to develop its stores to serve the Louisville area. Then, in 1972, Bacons' historic, old, downtown property in Louisville was closed and a luxurious new Bacons was opened to replace it in Bashford Manor. This ultra modern new store, 185,000 square feet in size, is one of the shopping showplaces of Louisville.

Bacons offers in-depth selection of popular merchandise including the Company's own private label merchandise. In addition, there is a healthy mix of famous brand names. Both concepts are blended to present a wide selection of fashion ideas. Fashion and good taste are stressed in all divisions from apparel to fine home furnishings.

Bacons has created a feeling of excitement in its stores. It adds excitement by featuring special shops that stimulate the imagination. Bacons has created a Designer Dress Shop, a Designer Sportswear Shop, a Custom Framing Shop, a Fresh Flower Shop, a Flower Arranging Shop and a complete Sound Shop.

Other services customers enjoy are the Home Decorator Shops and our very successful Beauty Salons. The Thoroughthreads Shop caters to the clothing needs of the young man.

Soon, the Shively store will open a free-standing "Rivets" Shop to merchandise Levi's jeans and related items to the entire family.

These special departments and others stress Bacons' recognition of customers' varied requirements and the stores' eagerness to respond.

Bacons has earned a reputation for quality and value. A liberal exchange policy and guaranteed customer satisfaction has enhanced that reputation and enabled Bacons to more than double its volume in the last decade.

An ongoing program of special fashion events has been developed and includes fashion presentations, clinics and workshops for clubs, sororities and career groups. Attention is directed to youth through our Teen Beauty Experience, a course for high shool girls, and through the many activities of the Fashion Board.

Bacons is proud of its heritage and proud of its personnel. To carry out its merchandising philosophy, the store has built an effective and creative buying staff.

Attention to the customer is of prime importance and the sales staff has been trained to recognize the value of excellent customer relations. Its people are interested, friendly and knowledgeable.

For many years Louisville has enjoyed a well diversified economy. Tobacco, distilling, chemicals, sporting goods, home appliances, automobiles and industrial equipment are key manufacturing industries here. They form the nucleus for many satellites and the business climate that encourages new investments. A strong economic environment and superior economic growth translates into a healthy outlook for retailing.

Bacons, the oldest retailing name in Kentucky, holds a key place, not only in the community life of Louisville, but throughout the Bluegrass State.

Mercantile Stores Company, Inc.

Department Store Divisions

Bacons

Established 1845

Louisville, Kentucky
Martin S. Margulis, President
- Bashford Manor
- St. Matthews
- Shively
- Jeffersonville, Ind.

Hennessy's

Established 1886

Butte, Montana
Milo D. Skordal, President
- Downtown Butte
- Helena

Castner Knott Co.

Established 1898

Nashville, Tennessee
Ralph T. Glassford, President
- Downtown Nashville
- Donelson
- Green Hills
- Harding Mall
- Rivergate
- Shelbyville
- Bowling Green, Ky.

the Jones Store co.

Established 1887

Kansas City, Missouri
H. Marvin Dorethy, President
- Downtown Kansas City
- Blue Ridge
- Overland Park, Kans.
- Prairie Village, Kans.

GAYFERS

Established 1879

Mobile, Alabama
Robert W. Holcomb, President
- Downtown Mobile
- Springdale
- Clearwater, Fla.
- Pensacola, Fla. (2)
- Tallahassee, Fla.
- Edgewater, Miss.
- Jackson, Miss.

Glass Block

Established 1887

Duluth, Minnesota
William G. Stubenvoll, President
- Downtown Duluth
- Miller Hill

joslins

Established 1873

Denver, Colorado
Donald R. Chabot, President
- Downtown Denver
- Aurora
- Boulder
- Englewood
- Greeley
- Pueblo
- Villa Italia

Peoples

Established 1888

Tacoma, Washington
Henry W. Powell, President
- Downtown Tacoma
- Lakewood
- Olympia (Lacey)
- Port Angeles
- Wenatchee
- Yakima

GAYFERS / MONTGOMERY FAIR

Established 1868

Montgomery, Alabama
Stephen E. Maxwell, President
Montgomery
Auburn
Eastbrook
Tuscaloosa

de Lendrecie's

Established 1879

Fargo, North Dakota
Ray Klein, President
Fargo

Lion

Established 1857

Toledo, Ohio
Philip W. Kaiser, President
Downtown Toledo
Southwyck
Westgate

McAlpin's

Established 1852

Ohio Operations
David R. Huhn, President
Downtown Cincinnati
Cherry Grove
Kenwood
Middletown
Northgate
Western Hills
Kentucky Operations
William R. Bartlett, President
Lexington, Ky. (2)

Root's

Established 1856

Terre Haute, Indiana
Frank C. Schrohe, President
Downtown Terre Haute
Honey Creek
Sullivan
Robinson, Ill.

Lazarus

Established 1889

Wilkes-Barre, Pennsylvania
Randolph L. Burnette, President
Downtown Wilkes-Barre

The Right House

Established 1843

Hamilton, Ontario, Canada
Russell W. Lackie, President
Downtown Hamilton
Brantford
Cambridge
Guelph
St. Catharines

J B White

Established 1874

Columbia, South Carolina
Thomas E. Hale, President
Richland Mall
Dutch Square

J B White

Established 1874

Augusta, Georgia
Robert W. Tyler, President
Downtown Augusta
National Hills
Aiken, S. C.

Represented in the markets by:

Mercantile Stores Company, Inc. (N. Y.)
128 W. 31st Street
New York, N. Y. 10001
Cable Address: Merstore

Stock Transfer Agent:

Chemical Bank
20 Pine Street
New York, N. Y. 10015

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399 Park Avenue
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